



Testimony
of
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NASD

As the world's largest securities self-regulatory organization, NASD has been helping to bring integrity to the markets and confidence to investors for more than 60 years. NASD was established under authority granted by the 1938 Maloney Act Amendments to the Securities Exchange Act of 1934. Every broker/dealer in the U.S. that conducts a securities business with the public is required by law to be a member of NASD. NASD's membership comprises almost 5,400 securities firms that operate in excess of 92,000 branch offices and employ more than 665,000 registered securities professionals.

NASD writes rules that govern the behavior of securities firms, examines them for compliance with NASD rules and the federal securities laws, and disciplines those who fail to comply. Our market integrity responsibilities include regulation; professional training; licensing and registration; investigation and enforcement; dispute resolution; and investor education. We monitor all trading on The Nasdaq Stock Market. We have a staff of 2000 and are governed by a Board of Governors – at least half of whom are unaffiliated with the securities industry.

As part of our mission to protect investors, NASD maintains the qualification, employment, and disciplinary histories of more than 665,000 registered securities employees of member firms through an automated, electronic system. This system, developed by NASD in cooperation with the North American Securities Administrators Association (NASAA), the organization of state securities regulators, is an on-line, Internet-based, registration database and application-processing facility which links federal, state and self-regulatory participants and the securities industry. This system, the Central Registration Depository system, is operated by NASD pursuant to an agreement with NASAA. Policies governing the system are established jointly by NASD and NASAA to ensure that the system meets the requirements of all participating regulators. NASD registration policy is set forth in NASD rules which are subject to SEC review and approval.

Public Disclosure Program and Need for Legislation

Records of securities professionals are available to the public through NASD's Public Disclosure Program. Background information on current registrations and employment experience and disciplinary actions is supplied. Information on disciplinary actions includes disciplinary actions by NASD or any other securities self-regulatory organization and state and federal regulators, reportable criminal convictions and indictments for certain criminal offenses, customer complaints, arbitration decisions, civil judgments in securities or commodities disputes, bankruptcies, and unpaid judgments/liens. This information is provided without charge to individual investors.

Currently, NASD is able to release this information to investors only in response to a written request or through our toll free telephone number. The requisite legal protections do not enable us to extend this information via the Internet in the same manner. If enacted, the Broker Accountability through Enhanced Transparency Act of 2003 would

give us the ability to provide this information to consumers using modern technology not contemplated in the original legislation establishing this system of disclosure.

The bill would also modify current law to conform the level of liability protection accorded to NASD for its other regulatory actions. The present “good faith” language provides a qualified protection standard that is at odds with prevailing federal case law holding there is no private right of action against NASD for acts or omissions taken pursuant to its regulatory responsibilities under the Exchange Act, and that NASD enjoys full liability protection for its regulatory actions.

The change in this language would have the beneficial effect of securing a uniform federal standard. The Central Registration Depository System and the Public Disclosure Program contain information that NASD collects pursuant to federal securities laws and regulations and subject to SEC approval. The current qualified standard subjects NASD to 50 sets of state defamation laws, and 50 possible standards for determining “good faith.” The current qualified standard would require NASD to conduct protracted and expensive discovery to prove in each lawsuit that it acted in good faith. By expanding the availability and likely investor use of information disclosed in the Public Disclosure Program, NASD is likely to experience a greater risk of being sued by dissatisfied brokers or investors. The proposed language establishes a uniform federal standard applicable to all 50 states.

The bill will also aid in enhancing the accuracy of records. The proposed amendment protects citizens who dispute their registration records by creating a process for them to challenge and correct their records. This procedural safeguard is not currently required by law, and provides the appropriate protection to brokers and investors.

Public Information Review

Informed investors are critical to market integrity and investor protection. The information that NASD makes publicly available about its regulatory activities and about securities firms and individual brokers plays a key role in informing investors.

Because of the importance of this information to investors and investor confidence, NASD is currently engaged in a broad review of the information it makes public.

A key focus of this review has been on the NASD Public Disclosure Program. We believe that the Public Disclosure Program could become an even better tool for investors. But the critical changes to the Public Disclosure Program, however, require enactment of the statutory amendments proposed in the Broker Accountability through Enhanced Transparency Act of 2003.

Public Disclosure Program Evolution

NASD began its Public Disclosure Program 15 years ago. The Public Disclosure Program has grown tremendously since its introduction. In its first year of operation, 1988, NASD

processed less than 6000 requests for information. Last year, NASD processed just under 2.5 million requests.

The NASD Public Disclosure Program has grown because of keen investor interest in researching the securities firms and brokers that they entrust with their investments. The program's growth, and its contribution to investor protection, has depended on making sure that it meets investor needs for convenience, ease of access, and scope of disclosure. And this service is free to investors.

Advent of the Toll Free Telephone Number

Initially, requests for information had to be submitted to NASD in writing. NASD would then mail the information to the investor. In 1990, with NASD support, Congress mandated a toll-free telephone number (800.289.9999) for investor requests. At the time, this was the easiest and most convenient way to provide information to the general public. Program usage grew substantially with this improvement. Unfortunately, the changes in the law that enabled NASD to release Public Disclosure Program information over the telephone did not contemplate the growth and popularity of consumers accessing information over the Internet.

In 1998, the program again grew dramatically when NASD began to accept requests for information through its Web Site. The Internet is unquestionably the preferred way to access information about securities professionals. Indeed, ninety six percent of requests are made through the NASD Web Site while only four percent are made through the toll-free telephone number created in the 1990 amendments.

The information provided through the NASD Public Disclosure Program has expanded as the program has matured. Information is now available about more than 850,000 brokers and more than 7000 securities firms. This includes over 650,000 active brokers and nearly 200,000 who became inactive within the past two years.

The information provided to investors is drawn from filings made through the Central Registration Depository operated by NASD. As part of the comprehensive registration and licensing regulatory process required by federal and state law, and NASD and other SRO rules, securities firms and brokers must provide detailed information to regulators. This information is collected through filings submitted to the CRD system by securities firms, brokers and regulators using uniform registration forms. Regulators use the information on these filings to determine whether to register or license a firm or broker and for other regulatory purposes.

The reported information falls into two broad categories:

- ? *Administrative* – information about the types of business a firm engages in, background information about a firm or broker, registrations and licenses held, and other information elicited by the uniform registration forms; and

- ? *Disclosure* – information about regulatory and disciplinary actions, criminal proceedings, certain civil and financial proceedings and, in the case of brokers, customer complaints and related arbitration or judicial proceedings required by the uniform registration forms.

Administrative information is available online through NASD's Web Site (www.nasd.com) and by phone through the toll-free NASD Public Disclosure Hotline (800-289-9999). To obtain disclosure information, however, an investor must request a written report. These written reports are sent by electronic or regular mail.

Today, the NASD Public Disclosure Program represents the best system currently available to investors for obtaining information about financial services firms and their professional staff. No other industry provides the ease of access and breadth of information about its firms and their professional staff to the public.

What Investors Want

As much as investors use and rely upon and appreciate the Program today, they have been very clear with NASD about how the Public Disclosure Program could be even more useful and responsive to their needs.

Investors want to see three major changes to the Program:

- ? First, investors want to be able to access all the information available through the Program via the Internet;
- ? Second, investors want access to as much information as possible about their securities firms and brokers; and
- ? Third, investors want this information to be presented in a way that is easy to understand and that gives them the option to see a summary of the information or to see it in full detail.

Access to All Information Online

H.R. 957 is essential to meeting these investor needs. Investors show a marked preference for using the Internet to obtain information about their securities firm and broker. Ninety-six percent of all requests made to NASD are now received via the Internet – a percentage that has steadily increased since Internet access was first made available in 1998.

Internet access offers the advantages of around-the-clock availability, clearer presentation of information, access to related information (on the site and through links to other sites), and usage tips and help.

Today, however, because the statute enacted in 1990 did not contemplate the Internet, the information available on NASD's Web Site is limited. The 1990 statute only provides NASD with protection from lawsuits if the disciplinary information we disclose is given out in a written response or through our toll-free telephone number.

NASD is only able to present administrative information online and not able to put disclosure information online. Investors who want to be able to complete their review of a firm's or broker's information must first go to the Web site, locate the administrative information there, request a written report for disclosure information, wait for the disclosure report to come via e-mail or regular mail, and finally review the disclosure information in full when the report is received.

Investors cannot understand why they must suffer this delay and complicated process when the Web sites they use for other purposes (e.g., research, banking, securities transactions, etc.) do not have these limitations.

Facilitating investor access to this information will mean greater transparency, better investor protection and strengthened market integrity.

Access to More Disclosure Information

The NASD Public Disclosure Program currently provides “current” or “reportable” disclosure information to investors. This is information that is required to be reported in response to the disclosure questions on uniform registration forms – including those questions that elicit disciplinary history.

This is a different approach from that taken by the SEC and state regulators. Firms are required to file the Form BD and Form BD/W uniform registration forms with the SEC. The Form U-4 is the Uniform Application for Securities Industry Registration or Transfer. Brokers must file this form to register with NASD and other self-regulatory organizations and to apply for securities agent licenses with the states. Brokers are required to file amendments on Form U4 any time reported information changes. The SEC considers all such forms to be public information available to investors pursuant to the Freedom of Information Act. This information is not available online, however, through the SEC.

Firms and brokers also are required to file uniform registration forms (Form BD and Form BD/W by firms; Form U4 and Form U5 by brokers) with any state in which they are licensed (e.g., any state in which they conduct a securities business). Whether these forms are public depends on applicable state law. Most states consider the forms to be public. Some state statutes (but not all) prohibit disclosure of certain kinds of information (e.g., Social Security number, home address). State information about securities firms and brokers is not generally available online.

As discussed below, the forms are specialized and complex. Most individual investors find them difficult and time consuming to understand. To be useful to investors, information must be drawn from the forms and presented in a clear and understandable manner.

Information that Is Easy to Understand

Understanding the detailed information reported to regulators on uniform registration forms is often a difficult task for individuals who work with this information on a daily basis. It can be even more challenging for the individual investor.

This is borne out in their questions and comments to NASD. Investors also want to be able to view both a summary of the information available on a particular securities firm or broker and to be able to drill down to the details as they choose. Summarizing the information also affords NASD the opportunity to provide context for the information reported. For example, providing information about the percentage of brokers with similar industry experience.

Online disclosure is the tool that can satisfy these investor needs. Familiar Internet techniques of linkages to other Web pages or sites, the ability to view summary and detailed information, at your option, and other tools can make the task of understanding complex information far easier than through the medium of a written report.

Privacy and Fairness

Fundamental privacy interests and protection against identity theft require that some information that brokers are required to submit to regulators when they register should not be made public. This information includes Social Security numbers, home addresses of the securities professionals, and physical descriptions. NASD does not make this information public today and will not make it public in the future.

In addition, while the uniform registration forms require brokers to report details of customer complaints that include the name of the customer, NASD does not release these customer names to the public.

Comprehensive online information about brokers is essential to assisting investors in deciding whether to begin or continue doing business with a broker. This warrants broad disclosure. When, however, a broker is no longer employed by a securities firm or is no longer subject to NASD's jurisdiction, the investor protection rationale for making the information publicly available is attenuated. Accordingly, NASD does not provide information on brokers that are not in the industry and are no longer subject to NASD's jurisdiction.

Since the primary purpose of the Public Disclosure Program is to assist investors in deciding whether to conduct or continue to conduct business with a securities firm or broker, access to the information is provided through an individual firm or broker query approach. An investor must specify the firm or broker that he or she is interested in obtaining information about. The Public Disclosure Program does not and would not provide broad search capabilities that might be used for inappropriate "fishing expeditions."

The uniform registration forms require securities firms to accurately and completely describe various disclosure occurrences. A broker, for example, is required to report the allegations made by a customer in a complaint about the broker conduct. The forms also provide the broker with an opportunity to provide his or her side of the story. The Program includes these broker or firm explanations.

NASD fully supports the other provisions of the bill. These include adopting rules to govern any disputes about the accuracy of Program information, keeping the toll-free number for investors who are not online, providing statutory liability protection for the Public Disclosure Program, and continuing its oversight by the SEC.

H.R. 957

The legislation introduced by Congressman Renzi, Chairman Oxley and Chairman Baker is essential to providing investors with easily accessible information to assist them in becoming informed about the securities firms or brokers that they entrust, or are considering entrusting, with their investments.

Technology and investor preferences and needs have changed since 1990, when the existing legislative provisions governing the Program were enacted.

Online disclosure is the best way to inform investors and it is the approach that they desire.

The bill also:

- ? Preserves toll-free telephone access for those investors who do not have access to the Internet;
- ? Allows investors to obtain information about securities firms and brokers that are registered with securities exchanges, but not with NASD;
- ? Requires SEC approval of the rules governing the Public Disclosure Program, including the scope and process for obtaining information;
- ? Ensures an SEC-approved process for disputing the accuracy of information reported by NASD;
- ? Provides appropriate liability protection to NASD for the operation of the Public Disclosure Program, and Is structured to ensure that the standards governing the Public Disclosure Program are uniform across the country and are not subject to the possibility of inconsistent or conflicting court decisions.

Conclusion

Investors want to be able to access all the information available to them via the Internet. They deserve access to as much information as appropriate on their securities firms and brokers, and they deserve that this information be presented in a way that is easy to understand.

If enacted, the Broker Accountability through Enhanced Transparency Act of 2003 would give NASD the ability to provide quick, accessible, one-stop disciplinary information to investors about the securities professionals with whom they trust their money. This would be a major step forward for the values of transparency, investor protection and market integrity that must be at the foundation of rebuilding public confidence in the U.S. capital markets.